No. 3433

United States Circuit Court of Appeals

For The Ninth Circuit

In the Matter of PETER THOMPSON, Bankrupt.

R. D. SIMPSON, Trustee of the Estate of PETER THOMPSON, Bankrupt,

Appellant,

vs.

L. H. MACOMBER, Receiver of the PETER THOMPSON COMPANY, a corporation,

Appellee.

Upon Appeal from the United States District Court for the Western District of Washington, Southern Division.

BRIEF OF APPELLEE

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ARGUMENT

I.

On the Motion to Dismiss the Petition to Review Under Section 24 (b) of the Bankruptcy Act.

The appellee has heretofore moved to dismiss the petition for review on the ground that this Court has no jurisdiction to entertain the petition, and

because the proper remedy of the petitioner for a consideration of the matter in controversy, in this Court, is by appeal, and not by petition to revise.

Sec. 25 (a) of the Bankruptcy Act provides:

> "That appeals, as in equity cases, may be taken in bankruptcy proceedings f r o m the courts of bankruptcy to the circuit court of appeals of the United States, and to the supreme court of the territories, in the following cases, to-wit * * * and (3) from a judgment allowing or rejecting a debt or claim of five hundred dollars or over. Such appeal shall be taken within ten days after the judgment appealed from has been rendered, and may be heard and determined by the appellate court in term or vacation, as the case may be."

The controversy brought to this Court for decision is one pending between the trustee and a creditor, over the allowance of a general, unsecured claim of over five hundred dollars. Appeal under Section 25 (a) is the method, and the exclusive method, for reviewing proceedings of this character in the Circuit Court of Appeals, and this is so, whether the facts be disputed or found.

Opposing counsel, on page 2 of his brief on appeal, which entire brief comprises three pages, says:

> "The trustee has both appealed and filed a Petition for Revision under section 24-b of the Bankruptcy Act of 1898. Nothing was considered by the District Judge other than ques-

> tions of law, and we are of the opinion, therefore, that the proper course to pursue in presenting this matter to the appellate court is by a Petition for Revision. As we understand the rule, if there are disputed questions of fact the remedy is by appeal, but if questions of law alone are involved the remedy is by Petition for Revision."

Opposing counsel is entirely wrong in his contention that because there are no disputed questions of fact under consideration and because questions of law alone are involved his remedy is by petition for revision.

A petition to revise, under Sec. 24-b will not lie under any circumstances for the purpose of obtaining a review of a decision of the District Court relating to the allowance or rejection of a debt or claim of five hundred dollars or over. The method of review is only by appeal under Sec. 25-a. Under no circumstances is an additional remedy afforded under Sec. 24-b, even though merely questions of law are involved.

This very point was considered by this Court in *First National Bank v. State Bank*, 131 Fed. 430, 12 A. B. R. 440, 444, wherein this Court said:

> "But in these cases it was held that no such rehearing or review could be had where the appeal is taken under the provisions of section 25-a. A general consensus of opinion is that, section 25-a having provided a means

to review three kinds of judgments, every other means is excluded."

In re Loving, 224 U. S. 183, 27 A. B. R. 852, expressly holds that the proceeding under Sec. 24-b permitting a review of questions of law arising in bankruptcy proceedings was not intended as a substitute for the right of appeal under Sec. 25. Further authority will be found in Sec. 2880 of Remington on Bankruptcy (2d Ed.) and the numerous cases therein cited.

Extended allusion to the authorities is unnecessary, inasmuch as the question has been definitely settled by numerous decisions of this Court, as well as in other jurisdictions.

The last word of this Court on this subject is found in:

Matter of Russell, 247 Fed. 95; 41 A. B. R. 234.

Matter of Creech Bros. Lumber Co., 240 Fed. 8; 39 A. B. R., 487.

See also:

King Lumber Co. v. Nat. Exch. Bank (C. C. A. 4th Cir.) 253 Fed. 946; 42 A. B. R. 651.

Matter of Monarch Acetylene Co. (C. C. A. 2d Cir.) 245 Fed. 741; 39 A. B. R. 818.

American Piano Co. v. Heazel (C. C. A. 4th Cir.) 240 Fed. 410; 38 A. B. R. 677.

Collier on Bankruptcy, (11th Ed.) 578, 579, 586.

Remington on Bankruptcy, (2d Ed.) Sec. 2880.

II.

On the Motion to Dismiss the Appeal.

Appellee has heretofore moved to dismiss this appeal because this Court has no jurisdiction of the same, and because the appeal was not sued out within the time limited.

Appellant on page 2 of his brief concedes that the appeal should be dismissed, but puts it on the ground "that the proper course to pursue in presenting this matter to the appellate court is by a Petition for Revision."

We entirely agree with him that the appeal should be dismissed, but not on the ground stated by him, and anticipating that he may hereafter change his position and contend that after all his proper method of bringing this controversy to this court was by appeal, we must proceed to argue the negative of this proposition.

The appeal must be dismissed because it was not taken within ten days after the judgment appealed from had been rendered.

The original and final judgment allowing the claim in dispute was signed and filed September 30, 1919. (Record, pp. 71, 72.)

The time for appeal therefrom expired on October 10, 1919, the limitation contained in Sec. 25 (a) being both distinct and imperative.

The petition for appeal was not in fact filed until December 1, 1919,—some fifty days after the right of appeal had been lost. (Record, pp. 78, 79).

It is true that the District Court vacated the judgment of September 30th and entered a new (?) order reallowing the claim in dispute as of November 24, 1919, (Record, pp. 132, 133, 134) and that the petition for appeal was filed within ten days after the last mentioned date.

The sole reason for this extraordinary proceeding on the part of the court below is expressed in the order of November 24th itself, reading as follows: (Record, p. 133).

> "The Court further finds that an appeal had at all times been contemplated by the trustee, to the Circuit Court of Appeals, in the event of an adverse decision by this Court, and that the delay in taking such appeal within ten days after September 30, 1919, was not caused by the culpable neglect of the trustee or his counsel, and believing that the trustee should have the opportunity of appealing seasonably, and that it lies within the discretion of this Court to enter this order. Now, therefore, it is ordered, that the claim of L. H. Macomber, as receiver, be and the same is hereby allowed as and of the date of the entry hereof, and that said order of September 30th heretofore referred to, be and it is hereby set aside and annulled."

The act of the District Court in vacating the original order allowing the claim on September 30th, and entering a new order of identically the same

effect, on November 24th, simply to circumvent the statute and to extend or revive a lost right of appeal, was not an act which lay within the discretion of the court, despite its assertion to that effect. *The later order is a nullity because the court was without jurisdiction to enter it.*

An appeal is a matter of right, given by statute, and can neither be restricted or enlarged by the District Court or the Circuit Court of Appeals.

In *Youtsey v. Nismonger*, (C. C. A. 6th Cir.) 258 Fed. 16, 44 A. B. R. 109, the court remarked:

> "Whether or not they are entitled to make the motion is unimportant, for it would be our duty to dismiss the appeal on our own motion in case it did not lie or was not taken in time."

In the case at bar appellant had filed a petition for rehearsing on the merits combined with a petition to vacate the order of September 30th,—the latter on the ground that *legal* notice of the signing thereof had not been given him. (Record, pp. 73, 74, 75). Both applications were made more than ten days after the order had been entered, and were obviously a pretense, the real purpose being to revive the lost right of appeal.

The District Court in effect so found by its order of November 24th, (Record, pp. 132, 133, 134) for by that order the petition for a rehearsing was denied. The application to vacate the order for want of sufficient notice of the entry thereof was also denied on that ground, but granted, as expressly

recited in the order itself, for the purpose of reviving appellant's right of appeal which had been lost by delay "not caused by the culpable neglect of the trustee or his counsel."

The practice of reviving a lost right of appeal by a petition pretended to be for a reconsideration of the merits, or by the subsequent entering of an alias order, as was done in the case at bar, has been condemned as an abuse of discretion and ineffectual to extend the time limit, in the following cases:

West v. McLoughlin, (C. C. A. Mich.) 162 Fed. 124; 20 A. B. R. 654.

In re Wright, 96 Fed. 820; 3 A. B. R. 154.

In re Girard Glazed Kid Co., 169 Fed. 152; 12 A. B. R. 295.

A case analagous to the one at bar is In re Berkebile (C. C. A. N. Y.) 144 Fed. 577; 16 A. B. R. 277. In that case an adjudication of bankruptcy had been entered on February 28. The court in its opinion says:

> "Thereafter an additional adjudication to precisely the same effect was filed in the clerk's office on March 1st. It also provided "the said Eppie B. Berkebile is hereby declared and adjudged bankrupt accordingly."
>
> "No appeal was taken from the adjudication of February 28th, but on March 11th an appeal was taken from the adjudication of March 1st.
>
> "Adjudication of bankruptcy having been filed in the clerk's office on February 28th, it

could be reviewed only by an appeal filed within ten days thereafter. Bankr. Act July 1, 1898, C. 541 sec. 25, 30 Stat. 553 (U. S. Comp. St. 1901 p. 3432). That time could not be extended by the subsequent entry of an alias adjudication. Therefore upon this appeal, taken more than ten days after entry, the adjudication of February 28th could not be reviewed. If the alias adjudication of March 1st were considered and set aside upon this appeal, such disposition of it would in no way affect the adjudication of bankruptcy of February 28th, which by failure to appeal from it has now become final.

"Appeals will not be entertained to argue moot questions only, and therefore this appeal is dismissed."

To the same effect is the opinion by the same court in re Goldberg, 167 Fed. 808; 21 A. B. R. 828. The entire opinion reads as follows:

"This is a petition by the bankrupt to revise an order of the District Court, Southern District of New York. On March 6, 1907, petitioner was adjudicated a bankrupt. He did not appeal, and the time limited by the statute (Act July 1, 1898, c. 541, Sec. 25a (3), 30 Stat. 553, (U. S. Comp. St. 1901, p. 3432)) for taking an appeal expired March, 1907. A year later, March 23, 1908, he moved the District Court to vacate the order of adjudication;

> his application was denied. This is merely an attempt indirectly to extend the time within which to review the adjudication of bankruptcy. That cannot be done. Matter of Berkebile, 16 Am. B. R. 227, 144 Fed. 577, 75 C. C. A. 333. Ordered affirmed."

In *Brady v. Bernard & Kittinger* (C. C. A. 6th Cir.) 170 Fed. 576; 22 A. B. R. 342, the Court said:

> "As an appeal was prayed or granted from the judgment of adjudication within ten days after its rendition, the time for appeal therefrom expired at the end of said ten days, and could not be extended or revived by any subsequent proceedings in the case."

Even if it be conceded that the Court had the right to grant an application, either for rehearsing or to vacate the order preliminary to the entry of a new order from the date of which the time for appeal would begin to run, such application must be filed within ten days from the date of the original order, and this was not done in the instant case. The combined petition for rehearsing and application to vacate the order of September 30th was not filed until October 14th.

The decision of the Supreme Court of the United States in re *Conboy v. National Bank*, 203 U. S. 141, 16 A. B. R. 775, is pertinent on this point, as well as on the general proposition that the lower court could not nullify the time limit for appeal by the expedient of vacating the order of September

30th and re-entering the order allowing the claim as of November 24th. That case involved an appeal from the Circuit Court of Appeals to the Supreme Court. The only distinction in the procedure seems to be that the time limit is thirty days instead of ten days. Justice Fullerton delivered the opinion and said:

> "No appeal lies from orders denying petitions for rehearing, which are addressed to the discretion of the court and designed to afford it an opportunity to correct its own errors. *Brockett v. Brockett*, 2 How. 238; *Wylie v. Coxe*, 14 How. 1. Appellant might have made his application for rehearing and had it determined within the thirty days, and still have had time to take his appeal. But he let the thirty days expire, as it did February 22, 1905, and did not file his petition until May 8, 1905. The right of appeal had then been lost and appellant could not re-invest himself with that right by filing a petition for rehearing.
>
> "The cases cited for appellant, in which it was held that an application for a rehearing, made before the time for appeal had expired, suspended the running of the period for taking an appeal, are not applicable when that period had already expired. 'When the time for taking an appeal has expired, it cannot be re-arrested or called back by a simple order of court. If it could be, the law which limits

the time within which an appeal can be taken would be a dead letter.' *Credit Company, Limited, v. Arkansas Central Railway Company,* 128 U. S. 258, 261."

Other late cases and authorities on the general propositions that the appeal must be taken as expressly provided by statute, within ten days after the judgment, that the time may not be extended, or the lost right revived by granting a petition for rehearing, or by any other subsequent proceeding in the case, will be found in the text, and the numerous annotations thereto, in the following works:

Collier on Bankruptcy (11th Ed.) 598.

Remington on Bankruptcy (2d Ed.) Sec. 2981, 2989, 2990.

See also the following late cases:

Matter of George Zeis (C. C. A. 2d. Cir.) 245 Fed. 737; 39 A. B. R. 380.

Matter of Monarch Acetylene Co. (C. C. A. 2d Cir.) 245 Fed. 741; 39 A. B. R. 818.

Finally, appellant will no doubt defend the action of the Court in vacating the order of September 30th on the ground that he did not receive such notice of the entry of the order as Equity Rule IV required, and hence was not bound by that date in figuring the time when the ten-day period for appeal began to run. That ground was the only one advanced by him in his application to vacate the order of September 30th, and constituted his sole excuse for not petitioning for an appeal within ten days

after that date. His statement on this point, as contained in his petition to vacate, reads as follows: (Record, pp. 74, 75)

> "That the trustee herein further petitions the court that the order heretofore made by this Court directing that the claim of the Receiver Macomber be allowed should be set aside and annulled for the reason that neither the trustee nor his attorney had been apprised of the entry of any such order (66) until a letter was received from the attorney for the receiver under date of October 13, 1919, in which he stated that such an order had been entered on the 30th day of September, 1919. That the Trustee's attorney, both in open court and to the receiver's attorney, stated that it was the desire of the creditors represented by the trustee that an appeal should be made from the decision of the District Court, and that the attorney for the trustee has been awaiting notifications of the entry of the order in accordance with the rules of practice of this court to which reference is made, namely: Rule IV which is as follows: 'Neither the noting of an order in the Equity Docket nor its entry on the order book shall of itself be deemed notice to the parties or their solicitors; and when an order is made without prior notice to and in the absence of a party the clerk unless otherwise directed by the Court or Judge shall

> forthwith send a copy thereof by mail to such party or his solicitor and a note of such mailing shall be made in the Equity Docket which shall be taken as sufficient proof of due notice of the order."

But neither in his petition nor in his affidavit in support thereof does appellant deny that he received notice of the presentation of the proposed order of Sptember 30th *before it was actually signed*, together with a copy of the proposed order. And the District Judge, in his order of November 24th setting aside the order of September 30th, expressly recites: (Record, p. 132)

> "On September 30, 1919, said W. W. Keyes received by mail from Leopold M. Stern of Seattle, a copy of said order, together with notice of its presentation to the Court for signature * * * *"

It may be admitted, as recited in the application to vacate the order that appellant had not received "actual" notice that the order of September 30th *had* been signed and filed, until October 13, 1919, on which date (Record, p. 133) "was *reminded* that said order had been signed and entered by this Court on September 30, 1919."

However, that point was not considered by the District Judge as ground for setting aside the order. In effect, the court below found that appellant had good and sufficient notice of the presentation of the order of September 30th, together with a copy

thereof, in time to be heard if the proposed order was not satisfactory; that he simply forgot about the matter until "reminded" thirteen days later that the order had "actually" been signed.

The District Judge, after affirming that the notification of the entry of the order had been given to the appellant, in accordance with the rules and practice of the Court, nevertheless set aside the order out of the goodness of his heart, because the mistake of not appealing seasonably "was not caused by the culpable neglect of the trustee or his counsel." And so the Court endeavored to extricate appellant from his dilemma and revive his lost right of appeal by the re-entry of this same order—the re-entry being made as of Nov. 24th.

That the action of the District Court in overruling the contention that the order had been entered without proper notification, in contemplation of Equity Rule IV., was right, is made clear in the case of Matter of Stafford, 240 Fed. 155, 39 A. B. R. 469, which case is strikingly parallel to the one at bar in numerous particulars. In that case a petition for discharge had been granted. Certain creditors had overlooked the entry of the order until the time for appeal had expired . They applied for an order that the discharge be opened so that they be permitted to appeal therefrom within ten days, as required by Sec. 25 (a). The Court denied the petition, and in an exhaustive opinion in which were considered the questions of time of appeal, the right

of the court to enlarge the time, or revive the opportunity when it had lapsed, as well as the requirements of the notice under Equity Rule IV, said:

> "The petitioners were in court and had due and timely notice of the filing of the opinion sustaining the report of the special master. The preparation and record of the order of discharge was purely a matter of routine, by filling up a printed blank provided for that purpose, the form of which is universal, and prescribed by the Supreme Court of the United States, and which followed the opinion as a matter of course, and required no findings of fact or law, and, indeed, no settlement of any kind. Furthermore, the right of appeal is merely a statutory privilege granted to an aggrieved party upon certain conditions, which must be complied with. It is not a right based upon principles of natural justice, and is not specifically granted by the Constitution, nor is it essential to due process of law. *Reetz v. Michigan*, 188 U. S. 505, 507, 23 Sup. Ct. 390, 47 L. Ed. 563; *Etchells v. Wainwright*, 76 Conn. 534, 540, 541, 57 Atl. 121.
>
> "It therefore follows that, if the appeal was not taken within the time fixed by statute, the right to take it was lost. *Conboy v. First National Bank of Jersey City*, 203 U. S. 141, 27 Sup. Ct. 50, 51 L. Ed. 128; *Credit Co., Ltd., v. Arkansas Central Ry. Co.*, 128 U. S. 258,

261, 9 Sup. Ct. 107, 32 L. Ed. 448; *Rode & Horn v. Phipps*, 195 Fed. 414, 115 C. C. A. 316.

"And it also follows from the authorities just cited that, as the pending petition was filed after the period for the appeal had expired, it had no effect in extending the time for taking the appeal. 'When the time for taking an appeal has expired, it cannot be arrested or called back by a simple order of court. If it could be, the law which limits the time within which an appeal can be taken would be a dead letter.' *Credit Co., Ltd., v. Arkansas Central Ry. Co.*, 128 U. S. 261, 9 Sup. Ct. 107, 32 L. Ed. 448, *supra*.

"The petitioners have strenuously urged that the case is controlled by equity rule 4 of the Supreme Court (198 Fed. xx, 115 C. C. A. xx), providing that, where an order is entered in the equity docket or equity order book without prior notice to, or in the absence of, a party, the clerk shall forthwith send by mail notice of such order to the parties' solicitors. But the answer to this is that this case was never entered, and indeed was never subject to entry, in the equity docket, and that the equity order book was not an appropriate or proper place for the entry or record of the order of discharge. While bankruptcy proceedings are in the nature of proceedings in equity, in that spirit, and not according to the letter, and

while a bankruptcy court may exercise full equity powers in the ascertainment and enforcement of the equities of the parties, and while, too, appeals in bankruptcy matters are regulated, except as otherwise provided in the Bankruptcy Act, like appeals in equity, it does not follow that the rule in question goes to the extent contended for it. The bankruptcy side of the court is as distinct from the equity side as either of these is from the law or admiralty sides, and their dockets and records are separately kept.

"The controlling fact to be taken into account in disposing of this petition is that the petitioner's solicitors, if they did not actually know, had the means of knowledge, of the entry and record of the order, which was entered and recorded as of course more than 10 days prior to the filing of this petition, and after the right to appeal had expired and been lost, and, having been lost, it cannot, as was said by the Supreme Court in *Credit Co., Ltd., v. Arkansas Central Ry., supra,* be arrested or called back by a single order of court, the granting or denying of which is in the court's discretion.

"The petition should be denied and dismissed, and an order to that effect entered. So ordered."

STATEMENT OF THE CASE

The claimant, Macomber, as receiver of an insolvent corporation, presented for allowance his proof of debt in the sum of $8500 in the bankruptcy estate of Peter Thompson. Attached to the proof was a duly certified copy of the proceedings of the Superior Court of the State of Washington, from which it appeared that the issues relating to the liability of the bankrupt on account of stock subscription had been directly before that court. Findings of fact, conclusions of law and a decree establishing the nature and extent of Thompson's liability had been entered, and by the terms of the decree the receiver was directed to file a claim for the amount determined as due from Thompson, in the latter's bankruptcy proceedings. (Record pp. 2-9.)

The trustee's counsel, presumably having examined the proof of debt and the certified transcript of the legal proceedings in the state court attached thereto as an exhibit, and while the subject was still fresh in his mind, within three days after the filing of the claim filed objections thereto (Record 1) which were treated by the referee as a demurrer. And, as recited by the refere in his decision, the sole grounds of the demurrer were, "1. That the claim is based upon a contingency and not a provable claim under the bankruptcy act. 2. That the claim cannot participate in the assets of this estate for the reason that the trustee never

accepted the shares of stock and has rejected the shares and all claim thereto on the ground that it is onerous and burdensome property." (Record p. 11.)

The referee sustained the demurrer and disallowed the claim. (Record p. 14.)

On review the referee was reversed by the District Judge. (Record p. 26.)

The next step was a new set of objections in which the original grounds were incorporated; but this time, and for the first time, the objection was raised that the proceedings in the Superior Court had "no legal efficacy or force, for the reason that no process of any kind was issued which would entitle or warrant said Superior Court of King County in assuming jurisdiction of the person or the subject matter of the action."

Certain other grounds were advanced, which while they might have been properly presented in the state court in opposition to the findings and conclusions made by that court, are not, as we contend ,issues which may be tried out in the District Court,—the proceedings in the state court, as shown by the exhibit to the proof of debt, being conclusive upon these matters and not subject to collateral atack. (Record pp. 27-33.)

The contention that the claim was based upon a contingency and not a provable claim under the Bankruptcy Act was again included in this second set of objections, but of course that question had

already been exhaustively argued on the first review of the referee's decision on that point and determined adversely to the trustee. (Record pp. 20-26.)

In due course these new objection reached the District Judge and were by the latter stricken. (Record p. 39.)

This left the record without any objections to the claim, but the referee nevertheless arbitrarily again disallowed the claim. (Record p. 37.)

On review of the last mentioned order the referee was again reversed, and a peremptory order entered on September 30, 1919, allowing the claim and directing the referee to restore it to the list of claims upon the record in the cause, as an allowed claim in the sum specified therein. (Record p. 71.)

This order was vacated by the District Judge on November 24, 1919, and reentered as of that date. (Record p. 132.)

In this status the controversy is brought to this court.

ARGUMENT ON THE MERITS

I.

Under this division opposing counsel argues the merit of his first objection to the claim, this objection being in effect as recited in Error A of his petition for review, (Record p. 143) that the judgment of the state court as shown by the certified transcript attached to the proof of debt had "no legal efficacy or force, for the reason that no process of any kind was issued which would entitle or warrant said Superior Court of King County in assuming jurisdiction of the person or the subject matter of the action." This ground is clearly an after-thought of opposing counsel. He did not suggest it in his original objections to the claim. Quite the contrary. As stated by the District Court in its decision on the first set of objections: (Record, p. 20) "No question is made of the method pursued in the state court in determining the question of liability on such stock subscription."

If counsel's first objection is in the nature of a demurrer to the validity of the judgment as recited in the certified transcript attached to the proof of debt, that question must be determined by the recitals in the transcript alone. Instead of relying upon this record, which was properly before the District Court, the trustee embraced in his objections a copy of an order of the state court fixing the time for hearing of the issues before that court and determining the method of service.

This order was not a part of the transcript attached to the proof of debt. The trustee then undertook to dispute the validity of the judgment recited in the transcript, upon the ground that the order above mentioned did not constitute such process as warranted the Superior Court in assuming jurisdiction of the person or the subject matter.

The District Court was right in refusing to go behind the judgment of the state court as shown by its transcript, to enquire into the formality or legality of any proceedings in the state court upon which the judgment is founded.

The certified transcript attached to the proof of debt as exhibit "A" (Record p. 3) shows that in a court of competent jurisdiction there was a fair trial upon the issues relating to the character and extent of Peter Thompson's liability as a stockholder in the corporation known as Peter Thompson Co. The transcript shows that Peter Thompson appeared in person at the trial and participated therein. Also he was represented at the hearing by his counsel, W. W. Keyes, who was then and at all times since has been, counsel for the trustee.

The record before the District Court also affirmatively recites that R. D. Simpson, as trustee of Peter Thompson, bankrupt, had filed an appearance in the action, although he did not participate in the trial. The record also contains express recitals that all necessary petitions and orders preliminary to the hearing "were duly and regu-

larly served in the manner required by law and the order of the court upon Peter Thompson and R. D. Simpson, as trustee of Peter Thompson, bankrupt."

The record also recites that the court heard the evidence on behalf of all the parties, examined the exhibits offered by the respective parties and then proceeded to make its findings of fact and conclusions of law and decree, "*upon the issues set forth in the pleadings, and upon the additional issues orally made up between all of the parties during the hearing.*" (Record, p. 4.)

It thus appears by the duly certified transcript of the state court proceedings attached to the proof of debt, that Peter Thompson and his trustee in bankruptcy were made parties to the litigation in the state court. They *appeared* and defended. They are therefore bound by the result, irrespective of the nature of the process which summoned them into court.

The questions of the sufficiency of the service of the process to bring them into the state court are unimportant. *They appeared in the litigation.* They did not question the jurisdiction of the state court when they appeared in that court. Peter Thompson in person and the trustee's counsel actively participated in the trial and accepted the issues "set forth in the pleadings and the additional issues orally made up between all of the parties during the hearing." Therefore, the findings and judg-

ment rendered upon these issues became binding upon them. They could not in the District Court contradict this record. It speaks for itself and its recitals as to the jurisdiction of the parties, appearances, scope of the issues, etc., became *res adjudicata* in the bankruptcy court. The remedy of the trustee was by application to the state court to amend its record to correct any error or to appeal from any erroneous judgment or order which the state court may have entered to the prejudice of the trustee.

Therefore, the first objection of the trustee to the proof of debt could not be entertained in law, to contradict the solemn recitals of the record of the state court showing actual general appearances by the parties to the controversy, participation in the tiral and contest of the relief claimed by the receiver. The bankruptcy court is bound by the presumption that everything contained in the transcript of the judgment of the state court attached to the proof of debt is true, and this presumption being *juris et de jure* excludes every proof to the contrary.

In re Diblee, et al., Fed. Case No. 3884, was a bankruptcy case which arose under the old Act. In that case the Court was asked to declare a judgment of the state court void. The Court said:

> "In respect to the confession of judgment, Diblee appears to have signed it with his individual name and also with his firm name.

> The other partners did not sign it and appear to have known nothing about it; and I am asked to charge that on that ground it is illegal and void. I do not conceive that this court has anything to do with that question. If the state court has permitted the jugdment to be entered up against all three debtors and the execution to be issued, I must presume that this was done in the legal and proper way. This court must treat the record of the state court as being in due form; and therefore although the other partners appear to have had nothing to do with giving the confession of judgment I must treat the judgment and execution as not being impaired by reason of any defect of that kind."

In re Burns, Fed. Case No. 2182, also a bankruptcy proceeding under the old law, the Court was asked to review the validity of the judgment of the state court. The Court said:

> "It was argued with great force and ability by counsel for the bankrupt that we were bound to interfere by injunction because this was not a valid judgment. But how do we know that? It is entered in a court of competent jurisdiction, whose authority it is our duty to respect. If it is fraudulent or void, under the bankruptcy law, it is the province of the assignee in bankruptcy, who stands in the attitude of a defendant, to see in that

> forum that no injustice is done to the general creditors. By the first Section of the Fourth Article of the Constitution of the United States it is declared "that full faith and credit shall be given in each state to the public acts, records and judicial proceedings of every other state'; and this is equally binding in the Courts of the United States. We must, therefore, refer the assignee in bankruptcy, as the representative of the defendant, and of all creditors, to the Court of Common Pleas of Jefferson County."

In re Keiler, Fed. Case No. 7647, was also a bankruptcy proceeding in which the bankruptcy court was asked to find that certain acts of the state court were not done rightfully. The opinion of the Court on this point is best stated by quoting the syllabus (5):

> "The acts of the state court done in the due exercise of their jurisdiction, not conflicting with the proper decrees and jurisdiction of the Federal Court, are valid and binding on the Federal Courts."

McKinsey v. Harding, Fed. Case 8866, was a bankruptcy proceeding wherein proofs of debt based upon judgments of the state court were filed for allowance. The trustee opposed the allowance of these claims on the ground of usury, and also upon the ground that the mental condition of the judgment debtor or bankrupt when process was served

upon him in the state court was such that the service was not legal. The Court held:

> "The question of the jurisdiction of the District Court to go behind the judgment of the state court and enquire into the condition of the debt upon which the judgment is founded, I think has been settled adversely In re Campbell (Case 2349) and reaffirmed in re Burns (Id. 2182). The plea of *res adjudicata* is conclusive except for the insanity of the alleged bankrupt alleged or some other informality or irregularity in the proceedings in the state court. But if insanity or any other matter of fact be ground for review of the judgment, a court of qeuity is not, but a court of law is, the proper forum for redress, and a writ of error *coram nobis* in the court wherein the judgment was rendered would be the proper method of redress. * * * I am of the opinion that the District Court cannot go behind the judgment, but that the assignees, if they desire to raise the question, must sue out a writ of error *coram nobis* in the court which rendered the judgment, and have it reversed."

In re Dunn, Fed. Case 4172, a question arose over the validity of a judgment in the state court. The bankruptcy court said:

> "The court holds that inasmuch as some of the alleged judgments for large amounts

> have not been impeached in the court which rendered them or in the appellate courts of the state having jurisdiction to correct the errors in said judgments, and inasmuch as as this court is not competent to correct or annul judgments of the court courts upon appeal or petition * * * ordered, therefore, that this petition be dismissed with costs."

Michaels v. Post, Book 22 L. C. P. Co. 520, U. S. S. C. Reports, was a bankruptcy case in which the validity of the judgment was questioned. The Court, on page 526, said:

> "Foreign judgments, by rule of common law, were only prima facie evidence of the debt adjudged to be due the plaintiff, and every such judgment was open to examination, not only to show that the court in which it was rendered had no jurisdiction of the subject matter, but also to show that the judgment was fraudulently obtained. Domestic judgments under the rule of common law could not be collaterly impeached or called in question if rendered in a court of competent jurisdiction."

The cases heretofore cited arose under the old bankruptcy act, but we find that the same rule has received sanction by our courts in construing the present bankruptcy law.

Robinson v. White, et al., 97 Fed. 33, 3 A. B. R. 88, was a case in which the trustee after litigating the validity of certain claims in the state court

endeavored to litigate the same matters in the Federal Court. The Court denied his right to do so in the following languege:

> "In my opinion there is no doubt whatever that the Owen Circuit Court had jurisdiction over the parties and of the subject matter, and that its decision in the case is conclusive and can only be reviewed for error in the Supreme Court of the State. This court disclaims all authority and power to revise collaterly the judgment of a court of co-ordinate jurisdiction which has taken cognizance of a cause, and has tried and disposed of the same. The judgment of the Owen Circuit Court, in the opinion of this court, until reversed by the Supreme Court of the State, is binding and conclusive alike upon the parties and upon this court."

Frazier v. Southern Loan & Trust Co., (C. C. A. 4th Cir.) 99 Fed. 707, 3 A. B. R., 710, is a case in which the validity of certain judgments of the state court was attacked by the trustee. The Court points out that "the proceedings in the state court, the record shows, were regular in every respect." The Court reasons that the trustee was authorized under the Bankruptcy Act to enter his appearance and defend any pending suit against the bankrupt. The general conclusion of the Court is best stated by quoting from the syllabus, as

reported in the American Bankruptcy Reports, as follows:

> "Where the record of the state court is regular in every respect, it may not be attacked collaterly for fraud and collusion by the trustee, where he could have set up such defense in the state court."

Handlan v. Walker, (C. C. A. 8th Cir.) 200 Fed. 566, 29 A. B. R. 6, was a case in which there was some controversy in the state court between the trustee and a claimant in which the latter obtained partial relief. He then presented to the Bankruptcy Court, a claim which he called "a balance still due, to be proved as a general claim against the estate."

The Court rejected the claim, and said:

> "As said at the outset, the controlling question is whether the judgment of the state court concludes the controversy and bars the further prosecution of the claim in the court of bankruptcy. We think it does. * * * The rule as to the conclusiveness of an adjudication when the same matter again comes up between the same parties is too familiar to require much restatement. It covers questions of both law and fact upon which their rights depend and those which might have been determined as well as those which were."

Clendening v. National Bank, 94 N. W. 901, 11 A. B. R. 245, was a case which arose in the

Supreme Court of North Dakota, in which a reverse situation is presented. In that case a claim had been filed in the Bankruptcy Court, and after some controversy was allowed. Thereafter the trustee in bankruptcy brought suit in the state court against this claimant for the recovery of a sum, alleging preference. The Court denied the right of the trustee to maintain the action on the ground that the controversy was concluded by the ruling of the Bankruptcy Court allowing the claim.

In that case, as in the case at bar, the trustee endeavored by collateral testimony to show that the Bankruptcy Court had not passed upon the merits of the particular matters which were in controversy in the suit brought in the state court. The state court denied his right to do so, saying:

> "This testimony was clearly inadmissible. It is true that parol evidence is admissible to show what was litigated in cases where the record leaves it silent; but even then the parol evidence must be consistent with the record. And it never can be admitted to contradict the record. See Bradner on Ev. (2d Ed.) Sec. 33, and cases cited. Freeman on Judgments, at Sec. 275, says: 'It is important that the evidence offered to explain a record should not contradict it. For it cannot be shown in opposition to the record that a question which appears by it to have been settled was not in fact de-

cided, nor that, where a special cause of action was in issue, a different matter was in truth litigated. In other words, where it appears by the record that a particular issue was determined, all question of fact is concluded and the court must, as a matter of law, declare such determination to exist and to be conclusive; citing numerous authorities.' "

The same Court then goes on to explain that the order of allowance of the Bankruptcy Court was conclusive on all points; that if the trustee was not satisfied, he had his remedy in the Bankruptcy Court by a review by the District Judge and by appeal to the Circuit Court of Appeals; that instead of pursuing that course, the trustee had seen fit to institute an independent action in the state Court; that the state court had no supervisory or appellate jurisdiction over the courts of bankruptcy. The Court says further:

"Whether the referee intended to decide these questions is not material. As we have seen they were necessarily involved, and were in fact determined by an adjudication. Whether his decision was right or wrong we need not discuss. It is sufficient for the purpose of this case to say that the question has been adjudicated by the order of allowance made by the referee and that the same has not been reconsidered by him or reviewed by the Judge upon a petition for review. If the trustee

> was dissatisfied with the adjudication, he had a speedy remedy in the Bankruptcy Court upon a petition for review, and also by appeal from the order of the Bankruptcy Court, if adverse to him."

And so, conversely, in the case at bar, the trustee having had his opportunity in the state court to litigate the very matters which he later sought to litigate in the Bankruptcy Court, these questions must be deemed to have been judicially determined by a tribunal having jurisdiction, and the result therefore binding upon the Bankruptcy Court. The trustee had his remedy by recourse to the state court to amend any improper order which it may have entered, or any improper recitals in its order. He had the right to appeal from the Superior Court to the Supreme Court. He did not have the right to ask the Bankruptcy Court to review the action of the state court.

While insisting that the proceedings in the state court, as shown by the proof of debt, were conclusive upon the Bankruptcy Court, and that any attack upon the legality of service, the sufficiency of the appearance by the trustee, the final decree of the state court determining the amount Thompson was obligated to pay, must be made by the trustee in the state court, we are nevertheless willing to meet the issues raised by opposing counsel, that the state had not full jurisdiction of the person and subject matter, to make the findings of

fact, conclusions of law and decree in question. It is our contention that the decisions of the Supreme Court of the State of Washington fully sanction all the acts of the state court, in question.

First, however, we desire to discuss the question of the trustee's appearance in the state court. Opposing counsel does not deny that Thompson appeared personally and participated at the trial in the state court. He does not deny that he, opposing counsel, was personally present at that trial and acted as Thompson's counsel. Until October 2, 1919, he did not question the recital in the transcript that the trustee had filed an appearance in the state court. On the last mentioned date, which was nearly eighteen months after the proof of debt had been filed, nearly five months after his final set of objections to the proof were filed, and two days after the order of September 30, 1919, finally allowing the claim in controversy, Mr. Keyes filed an affidavit *in the referee's office*, by which he attempted to contradict the recitals in the record relating to the trustee's appearance in the state court, by asserting that he had merely forwarded a stipulation on behalf of the trustee providing for a change of date of hearing in the state court, that this stipulation was as far as his appearance went, and that the stipulation had been filed in the state court without his knowledge. (Record, pp. 151, 152.)

Even if it were possible to contradict the record

by an affidavit in this matter, this objection cannot be heard because it was not seasonably made in the court below. As shown, this particular point was made by the trustee long after his objections had been filed and litigated in the District Court and after the final order of the District Judge allowing the claim. Certainly a mere affidavit filed in the referee's office some time after the litigation had been finally concluded cannot be made a part of the record on this appeal and the basis of any claim of error in this Court.

But in any event the point is without merit. Remington's Code of the State of Washington, Sec. 241, on the subject of what constitutes an appearance, says:

> "A defendant appears in an action when he answers, demurs, make any application for an order therein or gives the plaintiff written notice of his appearance. * * * Every such appearance made in an action shall be deemed a general appearance, unless the defendant in making the same states that the same is a special appearance."

The Supreme Court of the State of Washington has held in the following cases that a written stipulation on any point constitutes a general appearance:

Jones v. Wolverton, 15 Wash. 590, 47 Pac. 36;

Robertson Mtg. Co. v. Thomas, 60 Wash. 514, 111 Pac. 795.

The Supreme Court of the United States, in the following cases, has ruled that the trustee, having appeared in the state court in any proceeding, the judgment entered therein is binding upon him:

Winchester v. Heiskell, 119 U. S. 450;
Ludeling v. Chaffe, 143 U. S. 301;
Scott v. Kelly, 22 Wall. 57.

Certainly the stipulation which counsel says he signed and sent on to arrange to change the date for the hearing, constituted written notice of his appearance in the action. It had the effect of a general appearance, and this was true whatever attitude the trustee's counsel desired to take at the time the trial was had.

Coming now to the question of the validity of all the proceedings in the state court, as recited by the transcript attached to the proof of debt, we find that on page 8 of his brief opposing counsel approves the procedure followed by the receiver to the point of the hearing, but contends that the order or judgment at that hearing should have been confined to establishing the validity of the claims or alleged debts of the insolvent corporation, and a direction to the receiver to commence proceedings against the stockholders whose subscriptions were unpaid. He then goes on to argue extensively that the court exceeded its jurisdic-

tion *when it determined the amount Thompson was owing on his stock subscription.*

Counsel quotes from and relies very strongly on *Chamberlain v. Piercy*, 82 Wash. 157, 143 Pac. 977, as an authority. That very case expressly negatives the contention of opposing counsel. The trouble is that he has not fully and fairly stated the substance of the opinion, but has merely taken certain extracts which seem to support his case and italicized them in his brief. That case was an action by a trustee in bankruptcy to recover a judgment for unpaid stock subscription to the capital stock of a corporation. The Court stated the precise nature of the controversy in the following language:

> "The first question is whether the amended and supplemental complaint stated a cause of action. It should be noted that this amended and supplemental complaint makes no allegation (a) as to the value of the assets of the company, (b) that the defendants had notice or an opportunity to be heard at any time or place upon the validity of the claims gainst the insolvent company, and (c) *that the court, at any time after notice to the stockholders had determined what proportion of each stockholder's subscription remaining unpaid was necessary to meet the valid obligations of the company*, after the assets had been exhausted and after this finding had directed that pro-

ceedings be instituted against all such stockholders."

The Court then goes on to announce the rule as quoted by apposing counsel on page 8 of his brief. Then later on same Court quotes from *Beddow v. Huston*, 65 Wash. 585, 118 Pac. 752, as follows:

> "Any order the court might make should direct proceedings against all stockholders whose stock subscriptions were unpaid, for such an amount as, together with the admitted assets, would be sufficient to meet the liabilities and the cost of the receivership. The stockholders were entitled to notice of such a proceeding, in order that they might contest the liabilities of the corporation and their liability upon their unpaid stock. The court could then determine the liabilities, *and the proper amount to be assessed against or paid by each stockholder, and could then direct the bringing of suits to recover the amounts determined, if not voluntarily paid.* Such a liability, however, could only be determined upon notice to the stockholder and giving him his day in court. It could not be determined, as it was here, in an *ex parte* proceeding."

Later, in this same case, the Court said:

> "The action being an equitable one, the stockholder should have the right to have determined the validity of the claims *and the*

proportionate amount of his unpaid subscription which is necessary to meet the same, together with the other assets of the company, before the action proceeds against him for the full amount of his subscription."

The opinion concludes with the following language:

"The amended and supplemental complaint having failed to allege that the defendants had notice and an opportunity to be heard at some time or in some place upon the validity of the claims, *and having failed to allege that an acounting had been held by the court and the proportionate amount which each solvent stockholder should pay in order to meet the claims determined,* does not state a cause of action."

In the later case of *Rea v. Eslick*, 87 Wash. 125, 151 Pac. 256, the Court cites with approval, among others, the case of *Chamberlain v. Piercy*, *supra*, and *Beddow v. Huston*, *supra*, and quoting extensively from *Chamberlain v. Piercy*, announces the rule of procedure in the following language:

"This court has repeatedly held that, when a receiver has been appointed for an insolvent corporation, it is a condition precedent to his right to maintain an action against a stockholder for an unpaid subscription that such stockholder have notice and an opportunity to be heard upon the validity of claims against

> the insolvent corporation, and that on such notice an order be entered directing suit against the stockholders whose subscriptions are unpaid, for only such amount as, together with the assets, will suffice to meet the actual liabilities of the corporation and the costs of the receivership."

In that case, also, the Supreme Court held that the receiver had prematurely brought the suit to obtain judgment for $5,000.00 against a stockholder for unpaid stock subscription, because

> "The order upon which this suit is based, which was made in the original suit on December 5, 1913, did not make a determination of the *particular amount* or prorata share of the indebtedness that each subscriber to the capital stock should be required to pay."

And the Court reversed the court below, which had awarded judgment in favor of the receiver and against the stockholder for $5,000.00, upon the ground expressed in its opinion, as follows:

> "If we adhere to the rule announced in that case and the other cases above cited, it is clear, not only that the complaint did not state a cause of action, but also that the findings affirmatively show that the action against the appellant here was prematurely brought, *in that there had been no determination in the original receivership proceedings that $5,000.00, or any other specific amount,*

> *was either assessed as necessary to meet the valid obligations* of the company after the assets of the company had been exhausted, or that it has ever been found that the assets of the corporation are not sufficient to pay all valid claims against the corporation."

What else do these decisions of the Supreme Court of the State of Washington mean but that it is absolutely essential that there be a determination in the original receivership proceedings, of the *specific and proportionate amount* which each stockholder must pay, and a direction by the court in the original receivership proceeding to the receiver to bring suit for that certain and definite amount adjudged to be due from each stockholder, after the latter has had his day in court on a hearing to establish the validity of the claims filed in the receivership proceeding, the total amount of the available assets and the definite, fixed and proportionate amount of the unpaid stock subscription which would be necessary to collect from each solvent stockholder in order to meet the deficit.

In the nature of things, then, it is necessary that the court in the original receivership proceedings must have a hearing and determine to what extent each individual stockholder subscribed to the capital stock of the corporation, to what extent he made payment on his subscription, the amount of the deficiency that exists after computing the indebtedness of the insolvent corporation and de-

ducting the total avaliable assets, how many stockholders liable for unpaid stock subscription are solvent, and to what extent the total deficit shall be apportioned among the solvent stockholders in order to raise the required amount.

A definite and certain order must be entered against each stockholder *fixing the exact amount which he must pay*, the only limitation being that the amount so fixed, plus the amount theretofore paid by such stockholder, shall not exceed the par value of the stock subscribed by him. The amount to be assessed against each stockholder having thus been definitely ascertained, after due hearing, it becomes incumbent upon the receiver to bring a subsequent action to reduce such amount so assessed and fixed in the original receivership proceedings, to judgment against each individual stockholder, in the proper forum, which judgment may then be enforced by execution.

Certainly in such later action the only issues which can be raised by the pleadings and tried out are those mentioned as requirements of a complaint in *Chamberlain v. Piercy*, *supra*, to-wit: That the defendant had notice and an opportunity to be heard upon the validity of the claims, and that there had been an accounting by the court in the receivership proceedings, and the proportionate amount which each solvent stockholder should pay to meet the claims, determined.

Certainly in such later action to reduce the

claim to judgment the court would not reopen the enquiry made in the original receivership proceedings to determine the correctness of the amount assessed against and demanded of each stockholder. That subject was concluded by the findings and decree in the original action.

And so, in the instant case, Peter Thompson being bankrupt, the usual course of bringing suit to reduce the demand for unpaid stock subscription litigated in the original receivership proceeding to judgment, could not be pursued in the state court. The proper and only procedure was to file a proof of debt in the bankruptcy proceeding based upon the record in the state court. That was the direction of the state court, and such requirement was followed by the receiver. That record upon its face showed that all the requirements pointed out in *Chamberlain v. Piercy* had been performed; the amount Thompson was owing had been definitely assessed at $8,500.00. There remained, then, nothing for the bankruptcy court to do but to allow the claim, unless it appeared upon the face of the record that this was not such a claim as under Sec. 63 (a) of the Bankruptcy Act was provable in bankruptcy.

II.

Under this head, appellant complains that he should have had an opportunity to introduce evidence in the Bankruptcy Court in support of his

objection that Thompson's subscription to the capital stock had been fully paid by the transfer of his individual business.

For the reasons advanced in the preceding Division, the Bankruptcy Court was concluded on this point by the record of the state court, from which it appeared that that subject had been litigated in the state court receivership. The latter court expressly found that while Thompson had transferred to the corporation his individual business "in consideration of the issuance and delivery of $14,000.00, fully paid up capital stock," and while the business so transferred was of a fair value not exceeding $14,000.00, the business was in fact burdened with an indebtedness of $12,044.00 owing by Thompson, and which indebtedness was assumed by the corporation as a part of the deal by which the business was transferred to the corporation. (Rec. p. 6.)

The net result of this transaction was simply this: The corporation acquired a business worth not exceeding $14,000.00; it paid for it by the issuance of $14,000.00 of fully paid up capital stock and by paying or assuming an indbetedness of $12,044.00 owing by Thompson to his creditors. In other words, the corporation paid $26,044.00 for Thompson's business, which was worth not to exceed $14,000.00. Or, recasting the figures Thompson's equity in his business amounted to $1,956.00, being the difference between its value

of $14,000 and the indebtedness of $12,044.00. This equity, having a value of $1,956.00, was transferred by Thompson to the corporation in return for $14,000.00 of the fully paid up capital stock of the corporation. This sort of high financing is no longer permitted by the courts of the country.

A parallel case is *Lantz v. Moeller*, 76 Wash. 429, 136 Pac. 687, where the facts as recited in the opinion were as follows:

> "On July 17, 1911, the corporation being then indebted in the sum of $33,837.03, and being in an insolvent condition, in an action then pending in the Superior Court, Edwin F. Lantz was appointed receiver. The assets of the corporation being insufficient to meet its obligations, the receiver, upon due notice to each of the respondents, applied to the Superior Court for leave to make an assessment and call for the amounts alleged to be due upon the subscription contract. A hearing being had, the court found that an assessment and call was necessary. Thereupon due notice was given to each of the respondents, and demand for payment made, which was refused. Suit was brought against the respondent for the amount alleged to be due from each of them. The cause was tried to the court without a jury."

It will be observed that in the original receiver-

ship referred to in the foregoing case, the court fixed the specific amount of each stockholder's liability, for which amount demand was afterwards made and refused, resulting in the suit by the receiver. One of the questions involved was the sufficiency of payment for stock subscription, which payment had been made in property, and on this subject the Court said:

> "The respondents contend that, when the stock is paid for by the transfer of property, the liquidation of the liability on the subscription contract is complete, even though there may be a material discrepancy between the par value of the stock and the value of the property transferred in payment thereof, unless there is fraud in the transaction, either actual or constructive. According to this contention, it would be immaterial whether or not the value of the property transferred to the corporation in payment of the subscrip tion was substantially equivalent to the par value of the stock. It must be admitted that the expressions of this court, from time to time, have not been harmonious upon this question. The rule contended for by the respondents appears to be supported in the cases of *Turner v. Bailey*, 12 Wash. 634, 42 Pac. 115; *Kroenert v. Johnston*, 19 Wash. 96, 52 Pac. 605, and possibly some others. The opposite doctrine, that the stock of a corpora-

tion is a trust fund for the benefit of its creditors and that, when the rights of creditors are involved, the stock subscribed for must be paid in money or money's worth, is upheld in the following cases: *Adamant Mfg. Co. v. Wallace*, 16 Wash. 614, 48 Pac. 415; *Dunlap v. Rauch*, 24 Wash. 620, 64 Pac. 807; *Davies v. Ball*, 64 Wash. 292, 116 Pac. 833. In the *Adamant case, supra*, this court in an opinion written by the late Chief Justice Dunbar, said:

> " 'The doctrine that the stock of a corporation is a trust fund for the benefit of creditors is one which is founded in equity and fair dealing, and in any event has become so well established in this country that it can no longer be gainsaid. This doctrine was announced by Chancellor Kent, as early as 1824, in *Wood v. Dummer*, 3 Mason, 309, and since that time had become the established law of this country and is termed the "American Doctrine," although, as shown in the case above referred to, the same doctrine has long been established in England; and so universally has this doctrine been accepted, in America especially, that the citation of authorities seems a work of supererogation. We will, however, quote from 2 Morawetz on Private Corporations, Sec. 820, the rule which is

announced as follows: "Debts due a corporation are equitable assets, and may be reached by creditors through the aid of a court of chancery, if the legal assets which can be reached by execution prove insufficient. The liability of the shareholders to contribute the amount of their shares as capital is treated in equity as assets, like other legal claims belonging to the corporation. This liability, together with the capital actually contributed, constitutes the trust fund which in equity is deemed pledged for the payment of the corporate debts." This being true, then it must necessarily follow, for the protection of these creditors who dealt with these corporations, that the stock subscribed for must be paid in cash or in property of an equivalent value. In other words, the corporation must be in the actual condition which it represents itself to be in financially. If it were allowed to hold itself out as having a capital stock of $100,000.00, when in reality the capital stock, which is and must be under the theory of the law, assets in the hands of the corporation, is worth only one-half that amount, the corporation is to that extent doing business under false colors, and is obtaining credit upon the faith of an asserted estate which is purely fictitious.'

> "We think that the rule as laid down in the *Adamant case* is not legally but ethically sound, and all the decisions of this court which are not in harmony with the views therein expressed are overruled."

To the same effect is the later case of *German-Am. State Bank v. Soap Lake S. R. Co.*, 77 Wash. 332, 137 Pac. 461.

III.

Under this head the trustee argues that he should have been heard upon his objections to the effect that of the creditors whose claims had been filed in the receivership proceedings, some had been paid in full, and some were not proper claims against the insolvent corporation, but were debts contracted by Thompson individually before the corporation was organized. But these matters were certainly proper issues in the original receivership proceedings on the hearing based upon the order of March 23, 1918.

Counsel on page 9 of his brief quotes from *Chamberlain v. Piercy, supra*, and argues vehemently that *"the validity of the claims or alleged debts of the insolvent company,"* and a direction to proceed against the stockholders whose subscriptions were unpaid, were the only proper matters which could be adjudicated at such hearing. And the state court did adjudge at such hearing that claims aggregating $7,500.00 were "a true, just

and valid indebtedness against said Peter Thompson Co., a corporation." (Record, p. 5.)

How can the trustee now contend that the validity of these claims of creditors thus established in the receivership proceeding may again be tried out in the Bankruptcy Court through the medium of objections to the record of the state court attached as an exhibit to the proof of debt?

Further discussion on this point is unnecessary.

IV.

What has been said in the previous Division will apply to the argument of the trustee in support of Objection IV. or Assignment of Error D.

If for any of the reasons therein mentioned any of the creditors who filed claims in the receivership proceeding in the state court were estopped from asserting their claims against the insolvent corporation, such matters may have been, and certainly could have been, brought out at the hearing in the state court in which both Thompson and the trustee's counsel participated. That hearing was for the express purpose of passing "*upon the validity of the claims or alleged debts of the insolvent company*," as contended by opposing counsel himself on page 9 of his brief.

The finding of the court below that claims aggregating $7,500.00 constituted "a true, just and valid indebtedness against said Peter Thompson

Co., a corporation," precluded any further enquiry on that subject in the Bankruptcy Court.

V.

Under this division, counsel for the trustee argues that the claim of Macomber, as receiver, was based upon a contingency, and was not an existing debt at the time of the adjudication of bankruptcy, and hence, not a provable claim under Sec. 63 (a) of the Bankruptcy Act.

That ground of objection was urged by the trustee in his first set of objections to the proof of debt, and was overruled by the District Judge after exhaustive argument and submission of briefs by both counsel. The opinion of the court below on this point is found on page 20 of the Record.

The trustee petitioned for a rehearing, which was granted, and the opinion of the Court on the rehearing is found on page 22 of the Record.

We respectfully refer this Court to the opinions of Judge Cushman in the consideration of this subject.

It would seem to us that it was the duty of the trustee to appeal from the ruling of the District Court seasonably after the determination of that objection, but instead, the trustee filed a new set of objections, in which this same objection was incorporated. May he now by appeal or petition for review ask this Court to consider the propriety of the ruling made by the District Court on this

very same point as far back as January 22, 1919? (Record, p. 26.)

If it be held that this question is seasonably before this Court, we concede that it is such an objection as could properly be presented to the Court for consideration in determining whether upon the face of the proof of debt and exhibit attached thereto, it appeared that the claim was one provable under the Bankruptcy Law.

In our opinion, the law is decisively adverse to the contention of the trustee.

The Court should remember that the subject of stockholders' liability on stock subscription is a liability which is generally created by statute. The character of the obligation differs in each state. In determining this question, it is essential that the Code and decisions of the Supreme Court of the State of Washington be considered in deciding the nature of a stockholders' liability.

Remington's Code, Sec. 3698, reads:

> "Each and every stockholder shall be personally liable to the creditors of the company, to the amount of what remains unpaid upon his subscription to the capital stock, and not otherwise."

It seems to us that the case of *Johns v. Clother*, 78 Wash. 602, 139 Pac. 755, defines the character of a debt owing from a stockholder by reason of unpaid stock subscription. There the court, after quoting Sec. 3698 Remington's Code, said:

> "The Constitution and the statute create a liability as a matter of law to the extent of the value of the stock and no more, from the very fact of subscription, regardless of any attempted limitation of contract of subscription. *This liability may arise as an implication of law, even when there was no formal subscription.*"

We contend absolutely that this debt is not based upon a contingent claim, but is that character of debt covered by Sec. 63 (4) of the present Bankruptcy Law; that is to say, it is "founded * * * upon a contract, express or implied," and is therefore a provable debt against the estate.

We rely most strongly upon the case of *In re* Benjamin L. Rouse, 1 American Bankruptcy Report, 393. This case is squarely in point. The opinion is long and exhaustive. It was written by Harold Remington, then Referee in Cleveland, the author of Remington on Bankruptcy. That case involves the question of the provability of a claim against a stockholder for unpaid stock subscription. The Referee quotes the law and procedure relating to the enforcement of stockholders' liability in the State of Ohio, and this court will observe that they are analagous to the law and procedure of our own state. The Referee holds

> "That the statutory liability of a stockholder to answer for the unpaid debts of an insolvent corporation is not only a liability created

by statute, but is also a debt founded upon a contract."

He therefore rules that it is provable in bankruptcy under Division A of Section 63. The Referee, further discussing the time when the liability of the stockholder begins, holds (page 402):

> "The liability begins when the creditor gives his credit; is fixed when the corporation becomes unable to pay up the judgment against it for the debt, or what amounts to the same thing, when it makes a general assignment in a court of insolvency; and is payable when suit is begun or other demand made on his stockholder's liability."

This court will also observe that Referee Remington, in the latter part of his opinion, points out the method by which the amount of the stockholder's liability may be ascertained. He states that the bankruptcy court may either require the procedure in the state court (which was followed by the claimant in this estate) or, where the facts are simple and not complicated, the referee himself may liquidate and determine the proper amount of the stockholder's liability, and then allow that amount as a provable debt.

We also desire to call the Court's attention to the note contributed by Mr. Remington some time after he had written the opinion in the case above quoted, in which, in the light of later decision, he shows that his original ruling was correct. In

that note the case of *Garrett v. American File Co.*, 110 U. S. 288, cited by the trustee, is mentioned.

In the case of *Hays v. Wagner*, 18 American Bankruptcy Reports, 163; 150 Federal 533 (C. C. A. Ohio) the court held that a claim for unpaid stock subscription was a provable claim against a bankrupt, and could be used as one of the claims to join in the filing of an involuntary petition in bankruptcy.

Remington on Bankruptcy, 2d Ed., Vol. 1, Sec. 709, says:

> "Stockholders' secondary liability for debts of the corporation in some of the states is not only a debt created by the statute, but is also one founded upon an implied contract, and it is provable in bankruptcy if the circumstances are such that the claimant could have maintained a suit to enforce the stockholders' liability. It is fixed and not contingent, for all the facts necessary to fix it occurred. It is unascertained and unliquidated, and upon liquidation being made, it becomes provable and allowable."

The author cites numerous cases in support of the foregoing text. Among others is the case of *Dwight v. Chapman*, 12 American Bankruptcy Reports, 743; 64 L. R. A. 793; (Sup. Ct. Ore.) holding that a receiver appointed to collect the judgment on the stockholders' liability may prove the claim against the bankrupt stockholder.

Remington also cites in support of the foregoing text the case of *In re* Walker, 21 American Bankruptcy Reports, 132; 164 Federal 680; (C. C. A. Calif.) This case involves the California law, which provides that stockholders of a California corporation are liable for their proportion of all the debts of the corporation during the time they were such stockholders. The court holds that such a claim arises out of contract, is therefore a provable claim under the express terms of Sec. 63 of the Bankruptcy Act, and that such claim may be used in filing an involuntary petition in bankruptcy against the debtor.

Remington on Bankruptcy, 2d Ed., Vol. 3, Sec. 2742, reads:

"Stockholder's liability for the debts of the corporation is discharged by the stockholder's own bankruptcy if the facts essential to the maintenance of a stockholder's liability suit have already occurred."

Remington on Bankruptcy, 2d Ed., Vol. 1, Sec. 805, reads:

"Claims against a bankrupt stockholder for unpaid stock subscription are valid in bankruptcy."

In re J. L. Bass, 215 Fed. 275, 32 American Bankruptcy Reports, 766, inferentially holds that a claim by a receiver of an insolvent corporation against the bankruptcy estate of a stockholder based upon unpaid stock subscription may be proven

if it is established that the receiver of the insolvent corporation needs the funds to pay the debts of a corporation.

The case of *Van Tuyl, Jr., v. Schwab, et al.*, 161 N. Y. Supp. 328, 38 American Bankruptcy Reports, 161, in a case decided in 1916 by the New York Appellate Division, and is very much in point. In that case the Superintendent of Banks of the State of New York brought an omnibus suit against the stockholders of the insolvent Carneige Trust Company to enforce a stock subscription liability. One of the respondents, named Moore, pleaded a discharge in bankruptcy, and the question arose whether or not Moore's discharge in bankruptcy relieved him from his obligation and liability as a stockholder of the trust company. Or, as the court put it, "in other words, was his obligation and liability on April 12, 1911, a provable debt under the bankruptcy act?"

The court discusses quite fully the question of the time when the debt became provable and the time when the liability accrud. The court discussed the contention of the plaintiff that the liability of a stockholder does not rest upon contract, but upon statute, and that it does not arise until the insolvency of the corporation has been ascertained and an assessment has been levied upon the stockholders. The court disagreed with this contention of the plaintiff and held that the liability of a stockholder was contractual in its

nature; that there was an implied contract on his part entered into when he acquired his stock that he would be liable in the manner and to the extent prescribed by statute, and that such liability accrued, not when the company is ascertained to be insolvent, but when it acquires the indebtedness for which the statute renders the stockholders liable. In short, the liability is absolute at the time the stock is subscribed, but the enforcement of it, only, is postponed until the insolvency of the corporation takes place and an assessment is levied upon the stockholders.

The court concludes its opinion, which sustained the defendant Moore's plea of discharge, in the following language:

> "Strangely enough, there seems to be a notable dearth of authority upon the precise question as to whether such an obligation as defendant assumed as a stockholder of the trust company is a debt provable in bankruptcy. It was, however, directly passed upon by Harold Remington, Esq., the well known writer upon the Bankruptcy Act, when sitting as a Referee in Bankruptcy. In a careful, and well-reasoned opinion, too long to be quoted here, he held distinctly that such an obligation as attached to defendant as a stockholder of the trust company at the date on which the petition in bankruptcy was filed, was provable as a debt against his estate. Matter of

Rouse, 1 Am. B. R. 393. With his reasoning and conclusion we fully concur. If provable, it was discharged by the discharge in bankruptcy."

The cases we have thus far cited arose under the present Bankruptcy Act. An examination of authorities in point, under the old bankruptcy law discloses that they are likewise in harmony with the decisions of the courts under the pending Act.

The case of *Irons v. Manufacturers' National Bank*, 27 Federal Reporter, 591, was decided by the Circuit Court of Illinois. In that case a suit was commenced to enforce individual liability of stockholders of an insolvent bank. One of the stockholders pleaded a discharge in bankruptcy, and the question arose whether the liability of this debtor as a stockholder of the bank was a provable claim at the time the bankruptcy was pending, and if so, whether the bankrupt was discharged from such liability when he obtained his discharge from the bankruptcy court, in due course.

The court in its opinion (page 595) holds in effect that when the petition in bankruptcy was pending the individual liability of the shareholders of the bank had become fixed. The debts of the bank were a fixed quantity. The amount of the stock subscription of the bankrupt shareholder was easily provable, and the receiver of the insolvent bank might have proven this claim for individual liability against the estate of the bankrupt, al-

though the assessment had not actually been made at the time the petition in bankruptcy was filed.

Judge Blodgett, who wrote the foregoing opinion, referred to the case of *Garrett v. American File Co.*, *supra*, which had been cited by the receiver as an authority for overruling the bank's plea of discharge, apparently upon the ground that the debt for unpaid stock subscription, not being a provable claim against the estate, it was not extinguished by the bankrupt's discharge. However, Judge Blodgett says that the decision in the Garrett case was based upon peculiar facts in the record.

The case of *Carey v. Mayer*, 79 Federal Reporter, 926, is one decided by the Circuit Court of Appeals for the Second Circuit, which is strongly in point on the facts with the case at bar. In that case, one Mayer had subscribed to the capital stock of a Virginia corporation and had paid only a portion of his subscription. Later on, the corporation made an assignment for the benefit of it screditors by a common law deed. The Court in its opinion says:

> "By this assignment that part of the assets of the corporation which consisted in unpaid subscription for stock passed to the trustee, but the collection of this class of assets by actions at law could be started in motion only by a call made by the president and directors, or, failing that action, by a court of equity at the instance of the trustee or of the creditors."

Some time later a suit in equity was commenced, the object of which was to compel a call for so much of the unpaid subscription as would suffice to pay the debts of the company. A decree was made by the court which found the amount due the creditors, and made a call upon the stockholders to pay a certain percentage of the par of their stock, in order to administer the trust and pay the debts.

Subsequent to the assignment by the corporation and prior to the commencement of the equity suit to enforce the collection of the unpaid subscription, Mayer, a stockholder, was adjudged a bankrupt and later on he was discharged from all debts and claims which were provable against his estate and which existed when he filed his petition. Subsequently he was sued by the representativ of creditors of the insolvent corporation to recover the amount of the calls for unpaid stock subscription, and to this action the discharge in bankruptcy was pleaded in bar, and the Court directed a verdict for the defendant.

On appeal, the Circuit Court of Appeals affirmed the judgment, holding that the liability was a provable debt even before the calls were directed to be made by th equity court. Th Court says in th course of its opinion:

> "In the case of a liability for an unpaid subscription for stock, the seed of the liability is the act of subscription, and when notorious

> insolvency takes place and it becomes manifest by the act of the corporation that the subscriptions must pay the debts, the liability has also become manifest, but it requires a call or assessment to make it complete and of certain amount."

In the case above cited the calls for assessment had been made after the bankrupt had gone into bankruptcy, and in discussing the time when the obligation was created and the debt became provable, the court held that when the fact of insolvency has been confessed and an assignment for the benefit of his creditors has been made, nothing remains to be done in order to make the liability a fixed debt but to ascertain the amount of the assessment, by the intervention either of the corporation or of a court of chancery, and by reason of these facts the defendant's obligation as a stockholder became a liability when the assignment was made by the corporation on the ground of insolvency. The ascertainment of the amount of the liability was an incidental matter which could be made certain before final distribution of the bankrupt shareholder's estate and the claim thus be proven in said estate.

We thus find from the text and the cases hereinbefore cited that a claim based upon unpaid stock subscription under the laws of the State of Washington, and states having similar statutes, is a claim which may be used in a creditors' petition

in involuntary bankruptcy. It is a claim that is discharged by the discharge of the debtor in bankruptcy. It is a claim that may be proven against the estate of the stockholder if bankruptcy accrues or is established at the time the stockholder acquires his stock. It is based upon a contract, express or implied. The enforcement of the liability and the amount which the stockholder may have to pay may not be ascertained until later, as in this instance, after Thompson had gone into bankruptcy, but, as has been stated, his liability was created at the time he subscribed to the stock of the Peter Thompson Co. It was in existence at the time he filed his voluntary petition. It was therefore a provable debt to the extent definitely ascertained at the time when the proof of debt was filed with the Referee.

VI.

Finally, the trustee argues the merit of his objection that because the trustee never exercised any ownership over Thompson's stock in the insolvent corporation, the property could not be charged with any claim arising out of the unpaid stock subscription.

The record shows that the corporation had gone out of business, had become insolvent and its corporate stock worthless long prior to the bankruptcy of Peter Thompson. Naturally the trustee would take no interest in the paper certificates of stock which were then the only tangible remains of the

venture, so far as Thompson was concerned. But could Thompson's estate escape liability for any deficiency in the payment of the stock by the mere refusal of the trustee to exercise any interest in these paper certificates?

Had Thompson offered a composition in bankruptcy could he have ignored this liability in procuring the necessary majority of claims in amount and number, on the mere ground that the trustee had not taken these certificates in hand?

The trustee mainly relies for support on the case of *American File Co. v. Garrett,* 110 U. S. 288; but that case is not at all in point. It really does not involve the question of stock liability for unpaid stock subscription. That case originated in Rhode Island, which has some peculiar statute making each stockholder individually liable for the debts of the company in the event the company omits to file certain statements respecting its business, in the office of the Clerk of the Town. This liability seems to be transferred as a matter of course from one holder of stock to another. It seems that some effort was made to hold an assignee in bankruptcy liable under the provisions of this statute, and the Supreme Court simply held that under the peculiar facts of that case, the assignee had never really become the holder and owner of these shares of stock, and therefore could not be held for this penalty prescribed by the Rhode Island statute.

In the case of *Irons v. Mfg.'s Nat. Bank*, 26 Fed. 591, mentioned on page 29 of opposing counsel's brief as sustaining his position, Judge Blodgett, writing the opinion, referred to the case of *American File Co. v. Garrett* as based upon the peculiar facts in the record of the case, and therefore not contradicting the proposition that a debt for unpaid stock subscription was a provable debt.

We direct the Court's attention to the able opinion of the District Judge, which appears on page 25 of the Record, in which he discusses *American File Co. v. Garrett*, and holds that it has no application whatsoever to the case at bar.

If the appeal and petition for revision are not dismissed, the judgment of the court below should be affirmed upon the merits of the controversy.

Respectfully submitted,

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